THE LEGALITY OF VOTING TRUSTS. — As corporations increased in size, and the stockholders became great in number, constantly varying and widely scattered, the control, and with it the business policy, of a corporation became more and more subject to change. It was inevitable that efforts would be made to avoid this shifting control. The most effective scheme hitherto devised has been the voting trust, an arrangement by which the stockholders, or at least a majority of them, transfer their stock to trustees, who thus get and exercise the power to vote, in return for trust certificates, which are freely transferable subject to the trust.[1] In a recent case such an agreement was held invalid, the holder of a trust certificate being allowed to revoke the agreement at any time.[2] *Luthy* v. *Ream*, 110 N. E. 373 (Ill.). An earlier Illinois case sustained such a trust, the question of revocability not being involved and expressly not decided.[3] Though at first sight these cases may not appear entirely consistent, the present decision seems really to be a logical application of the reasoning of the earlier case. The court there treated the trust agreement as in substance nothing more than an exercise of proxies by the trustee. Such a construction deprives the voting trust of all its virility. Courts are inclined to look with disfavor on any attempt to make proxies irrevocable, usually holding them revocable notwithstanding contrary provisions, as being mere powers, not coupled with an interest.[4] But a decisive blow against the use of irrevocable proxies has been dealt by statutes, now very common, limiting the duration of proxies.[5] The Illinois court seems to have reached a logical result, if the voting trust can be regarded as a mere evasion of the limitations on the use of proxies. But this construction, it is submitted, is erroneous and unfortunate. A voting trust is an entirely different thing from a proxy. It is a real trust; the power to vote is not delegated, but the legal title, which carries with it the power to vote, is transferred. There is no more difficulty in creating a trust of stock than of any other kind of property. Further, the trust is not revocable as a dry trust, since it is really an active trust, both by reason of the power and duty to vote and by the interest each shareholder has in the participation of the others in the agreement.[6]

[1] There is no standard form for voting trusts, the provisions varying according to the requirements of each case. The duration is usually for a fixed term, three or five years being the most common, but a much longer period has occasionally been agreed upon. The trust may terminate upon the declaration of certain dividends, or when the financial condition of the corporation is such, in the opinion of the trustees, as to warrant it. A common provision is to allow the trust to be ended by a vote of a large proportion, say two-thirds, of the holders of the trust certificates. For a full discussion of the terms, in general and in particular, of voting trusts, see CUSHING, VOTING TRUSTS, 20, 36–99.

[2] For a complete statement of the facts of this case see RECENT CASES, p. 453.

[3] Venner *v.* Chicago City Ry. Co., 258 Ill. 523, 101 N. E. 949.

[4] Cone *v.* Russell, 48 N. J. Eq. 208, 21 Atl. 847; Schmidt *v.* Mitchell, 101 Ky. 570, 41 S. W. 929. 1 THOMPSON, CORPORATIONS, 2 ed., §§ 883, 884; 2 COOK, CORPORATIONS, 5 ed., § 610. But see Brown *v.* Pacific Mail Steamship Co., 5 Blatch. (U. S.) 525.

[5] In New York a proxy is good only for eleven months, unless some other limited time is specified in the proxy, and is always revocable. N. Y. CONSOL. LAWS, 1909, ch. 28, § 26. In Massachusetts a proxy must be executed within six months of the meeting at which it is used. MASS. REV. LAWS, 1902, ch. 110, § 25.

[6] See Boyer *v.* Nesbitt, 227 Pa. St. 398, 404, 76 Atl. 103, 105. See also the dissenting opinion of Justice Swayze in Warren *v.* Pim, 66 N. J. Eq. 353, 410, 59 Atl. 773, 794.

The only objection to voting trusts must then be based on grounds of policy. To say it is a restraint on alienation seems unfounded, since the trust certificates may be freely bought and sold, subject to the trust. A further frequent objection is that it is against the policy of the law to allow the separation of the voting power from the actual beneficial ownership, and that the voting trust is a mere blind to accomplish this.[7] Such a policy must be a survival of the obsolete notion, which prevented even voting by proxy,[8] that shareholders had a duty to participate personally in the management. A sounder view seems to be that it is an independent property right which is perfectly separable.[9] But the fundamental objection to voting trusts, the one which offers a real basis for attack upon grounds of policy, is the fact that such agreements may, and frequently do, lead to a minority control, since the majority of the majority will ordinarily control the vote of the block of participating stock. Such a control may perhaps be dangerous, but it has undoubted advantages in providing a continuous business policy. Great protection has been furnished in addition by the readiness of the courts to declare these trusts invalid where there has been any suggestion of an improper purpose, or any danger of unfairness to the minority stockholders — a strictness which has sprung from their earlier unmistakable hostility. Indeed it seems that most of these agreements which have come before the courts have been declared invalid for one reason or another.[10] Unfortunately a few cases have gone so far as to declare such trusts void *per se* as contrary to public policy.[11] But the more liberal tendency — to which the principal case is a regrettable exception — has been to reject such a flat rule, and to uphold the trust agreements when conceived for a lawful and proper purpose.[12] This is highly desirable, since the voting trust has become a useful instrument in the business world. In practice it is indeed used rather to protect than to injure the stockholder, its most valuable and common application being in cases of reorganization.[13] In fact its desirability has been so far recognized that in some states it now has express legislative sanction.[14]

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[7] See Harvey *v.* Linville Improvement Co., 118 N. C. 693, 699, 24 S. E. 489, 490. See the opinion of Justice Pitney in Warren *v.* Pim, *supra*, 66 N. J. Eq. 353, 373, 59 Atl. 773, 780. See also 24 HARV. L. REV. 51.

[8] Although now universally allowed by statute, at common law a stockholder could not vote by proxy. Taylor *v.* Griswold, 14 N. J. L. 222.

[9] See Carnegie Trust Co. *v.* Security Life Insurance Co., 111 Va. 1, 27, 68 S. E. 412, 421; Warren *v.* Pim, *supra*, 66 N. J. Eq. 353, 410, 59 Atl. 773, 795.

[10] Moses *v.* Scott, 84 Ala. 608, 4 So. 742; Shepaug Voting Trust Cases, 60 Conn. 553, 24 Atl. 32; Kreissl *v.* Distilling Co. of America, 61 N. J. Eq. 5, 47 Atl. 471; Venner *v.* Chicago City Ry. Co., *supra*, 258 Ill. 523, 101 N. E. 949. See also cases in following footnote.

[11] Harvey *v.* Linville Improvement Co., *supra*, 118 N. C. 693, 24 S. E. 489; Bridges *v.* First National Bank, 152 N. C. 293, 67 S. E. 770; White *v.* Thomas Inflatable Tire Co., 52 N. J. Eq. 178, 28 Atl. 75; Warren *v.* Pim, *supra*, 66 N. J. Eq. 353, 59 Atl. 773.

[12] Greene *v.* Nash, 85 Me. 148, 26 Atl. 1114; Boyer *v.* Nesbitt, *supra*, 227 Pa. St. 398, 76 Atl. 103; Carnegie Trust Co. *v.* Security Life Insurance Co., 111 Va. 1, 68 S. E. 412; Thompson-Starrett Co. *v.* Ellis Granite Co., 86 Vt. 282, 84 Atl. 1017. See Brightman *v.* Bates, 175 Mass. 105, 111, 55 N. E. 809, 810; Bowditch *v.* Jackson Co., 76 N. H. 351, 358, 82 Atl. 1014, 1018; 24 HARV. L. REV. 57.

[13] See CUSHING, VOTING TRUSTS, p. 12 *et seq.*

[14] MD. STAT. 1908, ch. 240; N Y. CONSOL. LAWS, 1909, ch. 28, § 25.